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AMEMBASSY BRIDGETOWN PASS TO AMEMBASSY GRENADA
AMEMBASSY OTTAWA PASS TO AMCONSUL QUEBEC
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E.O. 12958: DECL: 2020/01/06
TAGS: EPET EINV ENRG ECON VE
SUBJECT: VENEZUELA: OIL SECTOR STATUS AND FORECAST

CLASSIFIED BY: Darnall Steuart, Economic Counselor, DOS, Econ;
REASON: 1.4(B), (D)

¶1. (C) SUMMARY: 2009 has been turbulent for Venezuela's national oil company PDVSA. It continues to maintain debt to service companies in excess of $8 billion and issued over $6 billion in new bonds in 2009. Contrary to publically stated plans to invest $17 billion for the year, it invested less than $5 billion in the first half of 2009. With OPEC pegging Venezuela's current production at 2.35 million barrels per day (mbd), down 5.5% from 2008, plus a lack of investment, drilling, and maintenance activity, it is hard to envision a scenario where Venezuela maintains or increases crude oil production in 2010. It appears increasingly likely that the impact of service company nationalizations, maintenance failures, decreased activity levels, and on-going labor problems will result in further crude oil production erosion. END SUMMARY.

Production Estimates

¶2. (C) OPEC's December 2009 "Monthly Oil Market Report" listed Venezuela's 2008 production average at 2.487 mbd. Notwithstanding official GBRV and PDVSA production statistics claiming over 3 mbd of crude oil production, in the run up to its December 2009 meeting, OPEC estimated Venezuela's 2009 production at 2.35 mbd, or a decrease of 137,000 b/d or roughly 5.5%. In the absence of investment, Venezuela's natural crude production declination rate averages 20%. Thus, we assess that PDVSA, through 2009 investments and new production, possibly offset 15% of Venezuela's natural production losses. However, the effects of the May 2009 service sector nationalizations and low investment levels are still unfolding and could become more apparent in 2010. Assuming PDVSA looses 6% of its production in 2010, Venezuela's crude oil production could drop to 2.144 mbd by the end of 2010. According to DOE/EIA statistics, Venezuelan production surpassed this level in 1990. New production from the Faja, the focus of PDVSA's efforts, is not expected to reach the market for several years.

¶3. (C) If Venezuela were to fully implement OPEC's December 2008 production allocation cuts of 340,000 b/d, it would produce only 2.01 mbd. During 2009, PDVSA said publicly that it had taken

OPEC-related production cuts ranging from 186,000 b/d to 364,000 b/d. International oil company representatives have confirmed over the last year that at a minimum, PDVSA ordered 120,000 b/d restored out of the 189,000 b/d it said it had cut in January 2009. While PDVSA might substitute this restored production with cuts from its own fields (those it operates 100%, without international partners), no one believes this to be the case. [NOTE: Per reftels, Petromonagas' 90,000 b/d cut came back on line in July (BP) while PetroBoscan's 30,000 b/d cut was restored in April (Chevron). END NOTE.]

PDVSA Debts & Expropriated Service Companies

¶4. (C) According to press reports, PDVSA's outstanding debt to petroleum service companies and operators exceeds $8 billion even though it issued over $6 billion in new bonds in 2009. Chevron's Western Venezuela Operations Manager, Christopher Watley (protect) told Petroleum AttachC) (PetAtt) that Chevron's joint venture with PDVSA, Petroboscan, currently owes its contractors approximately $100 million. He stated, "We keep stringing them along and some are having problems paying their employees...Contractors continue to try to provide services in order to stay in the game to get paid. If you stop working, you go to the bottom of the list." Mauricio Moreno (protect), Baker Hughes International's (BHI) Venezuelan Sales Manager informed PetAtt that PDVSA paid some outstanding Bolivar-denominated debt with PDVSA 2014 bonds in December. [NOTE: Press reported PDVSA recently repurchased a quantity of the 2014 bonds. Post believes it used the repurchased

bonds to pay some service companies. END NOTE.] Several service companies confided to PetAtt that they agreed to reduce outstanding debt with PDVSA to secure some payments (one company confirmed it had agreed to reduce its pending invoices by 40%).

¶5. (C) Wood Group, Exterran, Tidewater, and Williams officials confirmed to EmbOffs that their legal cases seeking international arbitration are prepared and ready to be filed by counsel. They continue, however, to seek to negotiate compensation for their nationalized assets in the hopes of not shutting themselves out of future operations in Venezuela. According to industry sources, as of year's end, PDVSA has not compensated any of the 76 oil sector service companies nationalized in May 2009 and none are now engaged in active negotiation on a compensation package with PDVSA.

Production Problems

¶6. (C) Press reports continue to be filled with news of isolated labor stoppages and problems at various PDVSA facilities. The petroleum workers collective bargaining contract expired in January 2009 and the workers have yet to secure a new agreement with PDVSA. Maersk's Venezuela Manager, Luis Mantilla (protect), shared that two different crews working on one of its offshore drilling rigs in Lake Maracaibo had staged work stoppages, one regarding back salary payments and the other regarding dangerous work conditions on the platform. One of four gas turbines at PDVSA's Planta Lama block 9 gas compression platform on Lake Maracaibo exploded on December 27. According to Dave Beacham (protect throughout), the former General Manager of Wood Group's Simco (expropriated by PDVSA in March 2009), this platform compressed gas for injection into the reservoir for secondary crude recovery. Beacham speculated that poor maintenance could have resulted in a gas leak and subsequent explosion or that the explosion might have resulted from wet fuel gas being delivered to the combustion engine. In either case, the accident appears to be the result of poor maintenance or PDVSA's deteriorating capacity to adequately process natural gas for reinjection.

Activity Levels

¶7. (C) PDVSA's 2009 budget reflected $17.091 billion in planned investment, but according to a report covering the first six months of 2009, it spent $4.895 billion. Assuming it maintained that level of investment in the second half of 2009, final investment figures will not exceed $10 billion, over $7 billion short of its planned investment level. [NOTE: As the service company expropriations occurred in the first half of 2009, most service companies did not aggressively adopt a 'go slow' approach to working with PDVSA until the first half of the year was nearly over. It would be optimistic to assume that PDVSA maintained this level of investment as evidenced by a lack of solicitation requests in the second half of the year. END NOTE.] PDVSA reported 2008 exploration and production investment of $15.314 billion. Preliminary 2010 budget figures reflect planned investment of $23.151 billion.

¶8. (C) By all accounts, however, PDVSA activity levels are down. According to Alvaro Perez (protect throughout), the treasurer of the Petroleum Chamber (Camara Petrolera) and director of a petroleum equipment import business, there has been no increase in activity levels in the last half of the year. He claimed 2009 had the lowest activity levels he had seen in the last 25 years. Perez noted that since PDVSA has to follow the Public Law on Bidding and

Contracting, any increase in activity levels in the oil fields would need to be prefaced by an increase in solicitations issued by PDVSA and new contracts awarded, none of which has happened.

¶9. (C) PDVSA claims there are nearly 150 active drilling rigs in Venezuela, while Baker Hughes International (BHI) and OPEC believe the number is below 60. OPEC's December 2009 "Monthly Oil Market Report" (MOMR) indicated that Venezuela had 55 drilling rigs in 2004, 68 in 2005, 81 in 2006, 76 in 2007, 80 in 2008, and 55 in ¶2009. BHI's Moreno noted that BHI's rig count reports only "active" rigs, which means normal drilling activities (not maintenance rigs or work over operations). He agreed with PDVSA's statement that there are 149 rigs in Venezuela - 116 drill rigs and 33 work over rigs. However, 25% of the rigs located in Venezuela were disassembled ("stacked"), 40% were not working due to a lack of payments or contractual issues with the service company, leaving 35% involved in normal drilling activities.

¶10. (C) According to Chevron's Watley, PDVSA's Bajo Grande terminal on Lake Maracaibo currently contains 2.5 million barrels of crude petroleum stocks, down from a high of 6 million barrels from earlier in 2008. He explained that PDVSA provides large volumes of extra heavy crude during the March-October road construction season in the U.S. Additionally, Chevron and the Chinese have been lifting shipments from Bajo Grande and have driven the inventory down. Chevron's President of its Latin America Business Unit, Wes Lohec (protect throughout) confirmed to PetAtt that PDVSA's crude inventories are not building due to "some pretty good global demand for heavy oil."

¶11. (C) COMMENT: Post maintains its assessment that Venezuela's decreasing production will eventually force the GBRV to make hard economic choices. A decade of lost investment and production has put a premium on developing new fields. A handful of new and highly publicized international arbitration cases may be filed against the GBRV in 2010, which may further polarize the environment for investment in the sector. If the peaking of oil prices and their subsequent crash in 2008 set the stage for the events of 2009, 2009 provided a clear indication as to the future direction of PDVSA under current leadership. Planned municipal and National Assembly elections in 2010 are sure to divert attention

from oil production to campaigning as senior PDVSA and Energy Ministry representatives' responsibilities are shifted to politicking. President Chavez will react when he can no longer ignore the problems in the oil sector and work to shift blame away from his leadership (perhaps calling into question Rafael Ramirez's political future).

¶12. (C) The danger of a Venezuelan economic model predicated on ever-rising oil prices is clear: should oil prices stabilize or fall (as they have), at some point, the BRV would be forced to stop the growth in imports and government spending, and the economy would begin to contract further. As Post has consistently suggested, this economic model is unsustainable absent high oil prices and could lead to an economic crisis such as a significant devaluation and/or recession in a timeframe largely driven by oil prices. Venezuela is already in recession with current estimates predicting continued recession or anemic growth in 2010. END COMMENT.

¶13. (SBU) For more background on topics mentioned above, please see

the following cables:

Production and OPEC cuts - Caracas 106, Caracas 369, Caracas 1055, Caracas 1056, Caracas 1057, Caracas 1130;

Payments to service companies - Caracas 136, Caracas 214, Caracas 239, Caracas 288, Caracas 362, Caracas 428, Caracas 440, Caracas 541, Caracas 545, Caracas 548, Caracas 827, Caracas 854, Caracas 1129;

PDVSA's financial situation - Caracas 1246, Caracas 748, Caracas 564, Caracas 282, 2008 Caracas 276, 2007 Caracas 2346;

Faja development - Caracas 149, Caracas 495, Caracas 1236, Caracas 1240, Caracas 1326, Caracas 1333, Caracas 1352, Caracas 1465;

Nationalizations inside and outside the oil sector - 2007 Caracas 1281, 2007 Caracas 2013, 2008 Caracas 1690, Caracas 581, Caracas 592, Caracas 644, Caracas 707, Caracas 725, Caracas 817, Caracas 891, Caracas 1116, Caracas 1338;

Natural Gas projects - Caracas 828, Caracas 853, Caracas 1017, Caracas 1208, Caracas 1361, Caracas 1383;

Oil shifting to Asia - Caracas 104;

Domestic gasoline subsidy - Caracas 354;

Petrochemicals - Caracas 1131;

Mission creep in PDVSA - 2008 CARACAS 473.
DUDDY